

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Speier Analyst: Jeff Garnier Bill Number: SB 1760
Related Bills: See Legislative History Telephone: 845-5322 Introduced Date: February 23, 2K
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Conformity/ AMT Treatment of Charitable Contributions of Appreciated Property/ Contributions of Publicly Traded Stock to Private Foundations

SUMMARY

This bill would provide that charitable contributions of appreciated property would no longer be considered a preference item for purposes of the alternative minimum tax (AMT) and would allow the fair market value (FMV) of publicly traded stock (as opposed to the basis of the stock) contributed to certain private foundations as the amount of the charitable contribution deduction. These two items are current federal law.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon signature and would be operative for taxable or income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 2073 (1995-96)(failed in Senate Revenue and Taxation Committee), SB 14 (1995-96) (failed in Senate Appropriations), AB 265 (1997-98)(held at the Assembly Desk), AB 2258 (1997-98)(failed in Assembly Appropriations), and SB 1300 (1997-98)(income tax provisions amended out) would have conformed to the federal treatment of contributions of appreciated property. SB 1300 also would have conformed to the federal treatment of publicly traded stock to private foundations.

AB 1208 and SB 1430 are being considered in the present session and would conform to the federal treatment of contributions of appreciated property.

SPECIFIC FINDINGS

Existing state and federal laws allow deductions from income for charitable contributions. Individuals generally can deduct amounts up to 30% of their adjusted gross income for contributions of appreciated property to qualified charities. Corporations can deduct amounts up to 10% of their taxable income.

Under federal and state laws, in computing taxable income, an individual who itemizes deductions generally is allowed to deduct the FMV of property, including certain appreciated property, contributed to a charitable organization, other than private foundations. However, in the case of a charitable contribution of inventory, other ordinary income property or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property.

Board Position:

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_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald H. Goldberg

3/17/00

In the case of a charitable contribution of tangible personal property, the taxpayer's deduction is limited to the adjusted basis in the property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.

Under **federal and state law**, the amount of the charitable contribution deduction for gifts of appreciated property to private foundations is generally limited to the FMV of the property reduced by any long-term gain that would have resulted had the property been sold for its FMV (generally, the deduction is limited to the basis of the property.) Under **federal law**, since 1984, a gift of qualified appreciated stock to a private foundation is not limited to the basis of the stock. The FMV of the stock is deductible as a contribution. Qualified appreciated stock is defined as stock for which market quotations are readily available on an established securities market (the stock must be publicly traded.) When the federal provision for contributions of publicly traded stock to private foundations was enacted in 1984, it contained a sunset date of December 31, 1994. The federal provision was extended in increments of 12 to 18 months. In 1998, the special provision for the donation of publicly traded stock to private foundation became permanent.

California law conformed to the federal rule regarding the deduction for a contribution of publicly traded stock to private foundations until its federal sunset on December 31, 1994. California has not conformed to any of the extensions or the 1998 federal change making the special rule permanent. Therefore, under **California law** all charitable contributions to private foundations are generally limited to the basis of the property being donated.

Under federal law, charitable contributions of appreciated property are not treated as tax preference items. Prior to 1992, charitable contributions of appreciated property were treated as a preference item.

Under state law, for purposes of computing AMT, the amount of any deduction (generally the fair market value) for charitable contributions of appreciated property (real, personal, or intangible) that exceeds the taxpayer's adjusted basis in the property is treated as a tax preference item. In most cases, the B&CTL AMT calculation is not impacted because the allowable charitable contribution deduction for regular tax is limited to the adjusted basis of the contributed property.

This bill would conform California law to existing federal law by repealing the provisions that:

- Treat the deduction for an appreciated property charitable contribution as an item of tax preference for AMT purposes.
- Limit a charitable contribution of publicly traded stock to private foundations to the taxpayer's basis in the stock.

Policy Considerations

Conforming California law to federal law simplifies the preparation of California tax returns. This bill conforms to two federal provisions, thus making the preparation of California tax returns easier for some taxpayers.

Technical Considerations

Conforming to the federal treatment of gifts of appreciated property under the Bank and Corporation Tax Law would require the removal of a federal reference in B&CTL section 23456. Amendment 1 would remove this reference.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses are estimated as follows:

Fiscal Year Cash Flow Impact Effective 1/1/00 Enacted after June 30, 2000 (In Millions)			
	2000-01	2001-02	2002-02
AMT Charitable contributions	(\$10)	(\$10)	(\$10)
Deduction of Publicly Traded Stock	(\$8)	(\$8)	(\$8)
Total	(\$18)	(\$18)	(\$18)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The estimated revenue loss for these provisions has been significantly increased in comparison to estimates in prior years. This increase is due to considerable increases in the fair market values associated with the types of assets subject to this proposal, namely stock and real property.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1760
As Introduced February 23, 2K

AMENDMENT 1

SECTION . Section 23456 of the Revenue and Taxation Code is amended to read:

23456. For purposes of this part, Section 56 of the Internal Revenue Code is modified as follows:

(a) (1) Section 56(a)(2) of the Internal Revenue Code, relating to mining exploration and development costs, shall apply only to expenses incurred during income years beginning on or after January 1, 1988.

(2) Section 56(a)(5) of the Internal Revenue Code, relating to pollution control facilities, shall apply only to amounts allowable as a deduction under Section 24372.3.

(3) (A) Section 56(a)(6) of the Internal Revenue Code, as in effect on January 1, 1997, relating to installment sales of certain property, shall not apply to payments received in income years beginning on or after January 1, 1997, with respect to dispositions occurring in income years beginning after December 31, 1987.

(B) This paragraph shall not apply to any income year beginning on or after January 1, 1998.

(b) For purposes of applying Section 56(d) of the Internal Revenue Code, all references to "December 31, 1986," are modified to read "December 31, 1987," and all references to "January 1, 1987," are modified to read "January 1, 1988."

(c) Section 56(d)(1) of the Internal Revenue Code, relating to the alternative tax net operating loss deduction, is modified to include the provisions of Section 25108.

(d) For each income year beginning on or after January 1, 1988, and before January 1, 1990, Section 56(f)(2)(E) of the Internal Revenue Code, as it read during that period, is modified to refer to both of the following:

(1) Cooperatives under Section 24404 in lieu of the deduction allowed under Section 1382(b) of the Internal Revenue Code.

(2) Credit unions under Section 24405 as though the deduction allowed under Section 1382(b) of the Internal Revenue Code applied to credit unions.

(e) Section 56(g) of the Internal Revenue Code, relating to adjustments based on adjusted current earnings, is modified to provide that for corporations whose income is determined under Chapter 17 (commencing with Section 25101), adjusted current earnings shall be allocated and apportioned in the same manner as net income is allocated and apportioned for purposes of the regular tax. In

addition, each of the following shall apply:

(1) Sections 56(g)(1)(A) and 56(g)(3) of the Internal Revenue Code are modified to provide that the term "adjusted current earnings" means the sum of the adjusted current earnings of that corporation apportionable to this state and the adjusted current earnings allocable to this state.

(2) Section 56(g)(1)(B) of the Internal Revenue Code is modified to provide that the term "alternative minimum taxable income" means the sum of the alternative minimum taxable income of that corporation apportionable to this state and the alternative minimum taxable income allocable to this state.

(f) Section 56(g)(4)(A) of the Internal Revenue Code is modified to provide the following:

(1) In the case of any property placed in service on or after January 1, 1981, and prior to January 1, 1987, other than residential rental property for which an election was made under former Section 24349.5, the amount allowable as depreciation or amortization with respect to that property shall be the same amount that would have been allowable for the income year had the taxpayer depreciated the property under the straight line method for each income year of the useful life (determined without regard to Section 24354.2) for which the taxpayer has held the property.

(2) In the case of any property placed in service on or after January 1, 1987, and prior to January 1, 1990, other than residential rental property for which an election was made under former Section 24349.5, the amount allowable as depreciation or amortization with respect to that property shall be determined by each of the following:

(A) Taking into account the adjusted basis of that property (as determined for purposes of computing alternative minimum taxable income) as of the close of the last income year beginning before January 1, 1990.

(B) Using the straight line method over the remainder of the recovery period applicable to that property under the alternative system of Section 168(g) of the Internal Revenue Code.

(3) The amendments made to paragraph (2) by the act adding this paragraph shall apply to income years beginning on or after January 1, 1990.

(4) The last sentence of Section 56(g)(4)(A)(i) of the Internal Revenue Code, shall not apply to income years beginning before January 1, 1998.

(g) (1) Section 56(g)(4)(C) of the Internal Revenue Code, relating to disallowance of items not deductible in computing earnings and profits, shall be modified as follows:

(A) (i) A deduction shall be allowed for amounts allowable as a deduction for purposes of the regular tax under Sections 24402, 24410, 24411, and 25106.

(ii) For each income year beginning on or after January 1, 1990, a deduction shall be allowed for amounts allowable as a deduction to a credit union for purposes of the regular tax under Section 24405.

(B) Section 56(g)(4)(C)(ii) of the Internal Revenue Code,

relating to special rule for 100-percent dividends, shall not be applicable.

(C) Section 56(g)(4)(C)(iii) of the Internal Revenue Code, relating to special rule for dividends from Section 936 companies, shall not be applicable.

(D) Section 56(g)(4)(C)(iv) of the Internal Revenue Code, relating to special rule for certain dividends received by certain cooperatives, shall not be applicable.

(2) Section 56(g)(4)(D)(ii) of the Internal Revenue Code is modified to specify that Sections 24364 and 24407 shall not apply to expenditures paid or incurred in income years beginning on or after January 1, 1990.

(3) With respect to corporations which are not subject to the tax imposed under Chapter 2 (commencing with Section 23101), the amount of interest income included in the adjusted current earnings shall not exceed the amount of interest income included for purposes of the regular tax.

(4) Appropriate adjustments shall be made to limit deductions from adjusted current earnings for interest expense in accordance with the provisions of Sections 24344 and 24425.

~~(h) Section 56(g)(4)(I) of the Internal Revenue Code, relating to treatment of charitable contributions, shall not apply.~~